No. 17507-8-9

United States Court of Appeals
For the Ninth Circuit

MAX KUNEY, JR. and CONSTANCE K. KUNEY, His Wife; MAX J. KUNEY, SR., OLIVE R. KUNEY, *Appellants,*

vs.

WILLIAM E. FRANK, District Director of Internal Revenue, *Appellee.*

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON

REPLY BRIEF OF THE APPELLANTS

WARREN V. CLODFELTER
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TERMINOLOGY

In the record appellants Max J. Kuney SR. and his wife Olive are often referred to as Kuney SR. and Max J. Kuney JR. and his wife Constance are often referred to as Kuney JR. In its brief the appellee terms Kuney SR. and Kuney JR. "the tax payers." In this brief this terminology will be followed and appellee will be termed "The Government." The trial record is (R), the taxpayers brief is (TB), the Government's brief is (GB) and the taxpayer's reply brief is (TRB).

INTRODUCTION

The Government has not pointed to a single error or anything misleading in taxpayers STATEMENT. However, the Government has misused the testimony and exhibits in this case in an apparent effort to mislead this Court.

Whether or not such misuse is from carelessness or with deliberate intent to mislead, taxpayers consider it their duty to point to and correct such misuse. Taxpayers believe that some corrections are unimportant and some others are very important but realize it is their duty to direct all of the errors to the attention of this Court. Taxpayers will indicate the corrections considered of lesser importance by letters A and B, and will indicate those of greater importance by numbers 1 to 8, inclusive. Corrections below are stated in the sequence in which the errors appear in the Government's brief under STATEMENT (GB 4).

CORRECTION OF GOVERNMENT STATEMENT OF FACT

A. (GB7) The primary beneficiaries of the trusts were Caroline I. Kuney, age two; Max J. Kuney, age *nine,* and John R. Kuney, age *six* (corrections emphasized) (R100, 108, 265, 273).

1. (GB7 to 9) The terms of the trust instruments are misleadingly stated out of context. For Kuney Jr. trust read Article II (R359-362), and for Kuney Sr. trust read Article I (R371-374); *in context as written.*

2. (GB10) *Immediately* prior to the creation of the trusts on February 11, 1952 is misleading. The Kuney Family Partnership between Kuney Sr. and Kuney Jr. was formed in 1939 (R146) and is governed by partnership agreement executed and made effective January 1, 1940. "That was a very important agreement in my (Kuney Sr.) life, the most important." (R148).

3. (GB10) "but no change was made in the above partnership agreement. On February 11, 1952, effective

as of January 1, 1952, each grantor did execute an agreement with his trustee . . .'' The words *but* and *did* are misleading as they appear above, and we believe deliberately so.

B. (GB10) ''Subsequently, on February 7, 1957, effective as of January 1, 1955, a further agreement was made between the active partners, Kuney Sr. and Kuney Jr., that their respective salaries were to be paid so far as possible from partnership capital gains.'' is correct. However, the *further agreement* ''is simply (one of) a series of journal vouchers numbered one to a certain further place.'' (R181).

4. (GB11) The statements made in the paragraph beginning ''On February 11, 1952'' are incorrect. The fact is: On January 1, 1940, the date of the formation of the Kuney Family Partnership, the understanding was the profits were to be divided between Kuney Sr. and Kuney Jr. equally, regardless of capital investment in the business by those partners. R146, 147, 148 correctly states the partnership agreement through the words ''shall be equal'' near the bottom of R147. Thereafter, from the word ''PROVIDED'' to the word ''son'' near the top of R148 the signed original of this agreement in tax payer's files shows lines drawn through with bracket in margin and the words ''deleted by mutual consent MJK-MK Jr. March 11, 1942.'' The Agreement reads as follows:

> 1. THIS IS A PARTNERSHIP AGREEMENT entered into this first day of January, 1940 by and between Max J. Kuney, Father, and Max J. Kuney Junior, his son, hereinafter called the Father and the Son, and made for the purpose of operating all the busi-

ness of the firm MAX J. KUNEY COMPANY, hereinafter called the Firm, in all its branches in all the world.

2. The property of the firm is all that and only that now showing on the firms General Books of Account at Spokane, Washington and the investment of each partner is now and shall be that amount shown in each partners Capital Account.

3. The Father shall continue as the nominal head of the firm with final decision on all matters pertaining to the firm but it is contemplated that the Father will gradually retire from active management with decreasing duties and responsibility and that the Son will take over increasing duties and responsibility, but always with the Father continuing in full authority with final decision on all matters pertaining to the firm.

4. The Son shall give all his working time to the firms business, diligently pursue knowledge of the same in his spare time, and at all times actively Superintend and manage its affairs. It is contemplated that by the very nature of the firms business the responsibilities of the Son will be heavy and that his duties will involve a great amount of traveling with the hardships of a transient family life. This is fully understood between the parties hereto and the transfer of these duties and incident hardships from Father to Son is the very essence of this agreement.

5. It being considered that under the duties contemplated for each partner the Father will furnish experience beyond that of the Son while the Son will perform work beyond that of the Father, therefore, their respective salaries and shares in the firms profits shall be equal, ~~PROVIDED, however~~,

~~that before any profits are divided the Father shall receive interest at the rate of three (3%) per cent per annum on the amount his capital account exceeds the Son's Capital Account, except that this provision shall not operate until hereafter there shall have been the sum of $50,000.00 profits first divided equally between Father and Son.~~ [Deleted by mutual consent: MJK—MK Jr. March 11 1942].

6. The firms profits shall be determined annually at the close of each calendar year in accordance with principles of accounting consistently maintained by the firm, and shall be the identical amount accepted by the Income Tax Division of the U.S. Internal Revenue Service as being the Net Taxable Income of the firm for that year.

7. The partners shall have drawing accounts suitable to their respective stations in life with the determination of the amounts to be mutually agreed upon by the partners.

IN WITNESS WHEREOF, the parties have executed this agreement the day and date first above written.

Max J. Kuney
Max J. Kuney, Father

Max Kuney, Jr.
Max J. Kuney Jr., Son

"The 1957 agreement referred to . . ." *does not* make the same provision. It states what it states and means what it says. "The partners of Kuney Family Partnership (Kuney Sr., Kuney Jr., and three trust partners) agree that effective January 1, 1955, and until this agreement is changed in writing: (1) Active partners Max J. Kuney and Max Kuney Jr., shall receive total compensation $10,000 per year from Partnership

Income to be divided equally between them and that the remaining income shall be distributed in proportion to *each* partners Capital Investment in the Partnership (Exhibit G GB88, *emphasis* supplied). Comparison of income distributions for year beginning 1-1-1954 with income distributions for year beginning 1-1-1955, as shown on Schedule A of Appendix following TB6A, will reveal dollar effect negligible, "change in method of allocating income between the grantors and the trusts" (GB26) *none,* and business purpose simplification of formulas A and B stipulated for years 1952, 1953 and 1954. (R70 and TB5).

The statement "An equal division of profits between father and son was the practice of the partnership previous to the creation of the trusts" is correct. The next words "despite this, however" might cause the reader to believe that the words to follow will reveal some wrong committed. But the statement "the father's and the son's capital accounts, both before and after the creation of the trusts, were not equal" is right but not wrong. The statement "the equal division of profits (between father and son) was 'not in accordance with the (their) capital investment at all' " is correct, is right, *and not wrong.*

5. (GB11) The next two sentences in the Government's brief are correct: "On June 1, 1953, the partnership operations were reorganized; only the fixed assets (land, buildings, machinery and equipment) were retained by the partnership. That portion of the business formerly carried on by the partnership which consisted of constructing and conduct of actual opera-

tions was withdrawn from the partnership and thereafter carried on by the Max J. Kuney Company, Inc." (GB12).

The two sentences quoted above are *correct*. The next sentence is: "Kuney, Sr., testified that when the corporation was formed the trusts, as well as their grantors (Kuney, Sr., and Kuney, Jr.), were to receive an interest in the corporation (R165) through stock to be issued to the family partnership." (GB12). In this sentence the Government misused the record to present a conflict. Kuney Sr. actually testified as follows:

> THE COURT: Just tell us right to the point of who it was that was to own the stock in the corporation at that time.
>
> THE WITNESS: The Kuney Family Partnership. (R165)

There is no conflict. The trusts entire investment in the Kuney Family Partnership was in "the fixed assets (land, buildings, machinery and equipment) retained by the partnership." Obviously, the trusts could not and did not ever have any investment in the stock of the corporation nor "an interest in the corporation." A stock certificate dated May 31, 1953 reading: "Max J. Kuney Company General Partnership . . . $400,000.00" was written. This certificate was never recorded on the books of the corporation. In the eyes of the corporation it was never issued. Max J. Kuney Company General Partnership cancelled it (Exhibit Q4). It was incorrectly issued. (R166, 167, 168).

During the trial the Government settled the ownership of the corporation precisely, as follows: (Part page R241 through part page R243)

Question: All right. Now, our next question is about the formation of this corporation and who owned it, Mr. Bowen, so we can lay that at rest, and before I ask the question, I invite to your attention the language on Page 2 at the bottom,

"The Kuney Family Partnership capital was invested entirely in fixed assets consisting of equipment, machinery, land, and buildings, held out of the corporation in 1953 for the main reason: The corporation, with W. R. Wiginton and W. B. Peterson holding their agreed 20 per cent interest, would live on and be a reliable caretaker and user of such fixed assets after the adult Kuneys would die and would provide a steady and carefree income to their widows and the trusts for their children by paying them for the use of such fixed assets." (Exhibit G).

Now, I invite your attention also to the next bookmark which I have placed in there, Mr. Bowen, which is, may we call it, a journal entry on journal voucher two, sir. Do you see it there, or could I help with it, June first, 1953? Journal voucher two?

These are accounting journal entries are they not?

Answer: (by Harold V. Bowen) Yes.

Question: And above the one I invited your attention to, we see typing across 'MJK' and below we see the same typing, 'MJK.' What does that mean?

Answer: That indicates the journal voucher was prepared by Max J. Kuney.

Question: Senior or Junior?

Answer: Presumably, Senior.

Question: Now, this journal voucher entry to an accountant on the basis of this journal entry, what does the debit to capital, Max J. Kuney, two hundred thousand dollars, debit to Max J. Kuney, Jr., two hundred thousand dollars, and credit to the account of 2801, capital stock, dated June 1, 1953, mean to you, Mr. Bowen, as an accountant?

Answer: It means that Account 2861 capital for Max J. Kuney, Jr., was charged with two hundred thousand dollars and the account 2801 was credited, which would be the corporation capital stock account, two hundred thousand dollars.

Question: And if you assumed with me for the moment, Mr. Bowen, that $400,000 represents all of the capital stock of the corporation at that time, as an accountant from this journal entry, who were the owners of such capital stock?

Answer: Max Kuney and Max Kuney, Jr.

Question: How about the children, the trusts?

Answer: This doesn't indicate the children as owning any.

Question: And the date, again, is what?

Answer: This is dated June 1, 1953.

Question: All right. Now, let's look at the next date, December 31, 1956. Now we see a debit to Mr. Wiginton for $80,000; to Mr. Petersen for $20,000, and corresponding credits in the capital stock account.

Answer: Yes, that is correct.

Question: Now, as an accountant, from this journal entry when was the first time that Mr. Wiginton or Petersen became shareholders in this corporation?

Answer: December 31, 1956. (R243)

6. (GB12) The statement "No dividends were ever paid by the corporation . . .", is true. The testimony is:

"Question: Did the corporation stock pay any dividends?

Answer: No.

Question: Has it ever paid dividends?

Answer: No, it has not." (R221)

The Government says: "No dividends were ever paid by the corporation *to the partnership*" (R221) with emphasis supplied by its next statement which is not supported by the record and *is incorrect.*

The statement: "The effect of the formation of the partnership was to cause its total income to consist entirely of rental and interest payments made by the corporation to the partnership for the use of the partnership's fixed assets" is not supported by the record (R173, 186-187) and is incorrect. The fact is: In the year beginning January 1, 1954, when the formation of the corporation first affected the division of partnership income the partnership received $55,571.02 income from "rental and interest payments made by the corporation to the partnership for the use of the partnership's fixed assets" and in addition received $63,-352.58 net long term capital gain (Stip 9, R54 and TB5), from sale of its fixed assets to others.

7. (GB12) The last sentence beginning "As a matter of fact" is misleading. It should read: The rental rates for the partnership assets used by the corporation during all years were determined at the time by the parties directly involved but were changed by In-

ternal Revenue Agent Francis A. Carney (R189, 190, 328-330) in 1956 (Exhibit G).

8. (GB12) The statement "Partnership assets were pledged as security on bank loans to the corporation" has no foundation in the record except in this and/or question propounded to banker Coon by the Government:

> "Question: And you accordingly know that the partnership has pledged and/or made available to the corporation its fixed assets?
>
> Answer: That is right." (R208)

We submit that banker Coon should have answered the first part of this question "No" and the last part as he did. As proof we offer his entire testimony as it appears in the record (R204-213). We further submit that it reveals: The Kuney interests have never pledged any of its assets *to the bank in which he has been employed in Spokane for eleven years prior to 1960* (R204). The questions by the Government and the answers by Max J. Kuney Jr. are as follows (R295-296):

> "Question: And you recall Mr. Coon testifying on the stand too, don't you, Mr. Kuney?
>
> Answer: Mr. Coon, yes.
>
> Question: And about the bank loaning the money and that?
>
> Answer: Yes.
>
> Question: And if I asked him if it is true that the corporation ever pledged some of this property for the money that the corporation wanted to borrow at the bank? Do you remember a question such as that?
>
> Answer: Yes.

Question: And his answer was yes?

Answer: That is right.

Question: And that is true, isn't it?

Answer: That is true.

Question: And who does that property belong to?

Answer: It belongs to the various partners.

Question: But who is borrowing the money, the corporation?

Answer: The corporation is signing the notes on the money.

Question: And at that time did the children have any interest at all in the corporation?

Answer: No, sir."

As a matter of fact the only property ever mortgaged or pledged was when the Max J. Kuney Company Corporation and Lloyd W. Johnson, doing business as Kuney Johnson Company *did mortgage* to the Bank of California at its main office at San Francisco its property at 225 Shaw Road South, San Francisco, as security for a loan made to Kuney Johnson Company in 1954. This loan and this mortgage shows on the December 31, 1954 Balance Sheet of Kuney Johnson Company (Exhibit 32, Sheet 15) and on the December 31, 1954 Financial Statement of Max J. Kuney Company (Exhibit 32, Sheet 5) as "Notes Payable (Mortgage on Property at 225 Shaw Road, San Francisco)—Portion Due After One Year "$107,160.00." The same also shows on the portion of Exhibit 32 printed at GB83. This note and mortgage does not appear at any place on the next following December 31, 1955 Financial Statement of Max J. Kuney Company (Exhibit R). Sheet 5 of Exhibit R shows:

Land and Building Held for Investment—
Schedule "K"—225 Shaw Road, San Francisco—

Purchase Price	192,500.00	
Less Depreciation Reserved	12,483.00	180,017.00[1]

Amended 1956 U.S. Partnership Return of Income prepared and stamped by Cole, Bowen and Company for Kuney Family Partnership (Exhibit 38 B-1) shows: "Line 26, Net long-term capital gain (or loss) (from line 6, Schedule D).....$32,014.43." Line 6, Schedule D shows nothing. Line 3, Schedule D shows $32,014.43. Mr. Bowen incorrectly listed Net long-term capital gain as Net short-term capital gain. However, the dates show "Assets held more than six months." One of the Assets is Land and Building (California property) cost $192,500, Depreciation $13,091.33, Gross sales price $215,000.00, Date sold 2-1-56, Expense of sale $6,687.50, Gain $28,903.83.

The Government's final point stated at GB13 is argument and has no place in its statement. This point will be treated in its proper place below.

SUMMARY OF ARGUMENT

Max J. Kuney and Max J. Kuney Jr. were the partners of the Kuney Family Partnership from its commencement in 1940 until December 31, 1951. Each partner's capital account represented his capital investment in the Kuney Family Partnership. Profits and losses were shared equally all in accordance with the partnership agreement. As of January 1, 1952, each

[1] Note—Land and Building sold February 1, 1956 for $215,000.00. $195,000.00 installment note payable monthly at rate of $1,300.00 commencing March 1, 1956. Secured by Deed of Trust.

partner made a bona fide gift of $100,000 of this capital executing proper partnership and trust instruments and federal tax reports and made the proper entries in the accounting records of the Kuney Family Partnership. The adult Kuneys continued to manage the business affairs of the Kuney Family Partnership and each as trustee for the other managed the partnership interest held by him in trust for the minor Kuneys. The transfers of the ownership of the interests in the Kuney Family Partnership were real and bona fide and the donees became partners in the Kuney Family Partnership. The fact that the trusts did not perform any services, let alone "vital services" or contribute any "original capital" is not determinative. It was neither anticipated nor required that such be the case. Services performed by the managing partners were compensated by reasonable salaries. Controls retained by the adult Kuneys were only those required as managing partners and did not reach the maximum extent allowable under the law. The managing partners' handling of trust affairs has consistently been for the benefit of the trusts. The so-called heavy burden of proof allegedly required in these circumstances was met as evidenced by the jury's finding that the adult Kuneys as trustees were bona fide partners in the Kuney Family Partnership for Federal income tax purposes. Therefore, the sole question here is whether or not the adult Kuneys made bona fide gifts of a part of their partnership interests in the Kuney Family Partnership thereby making the donees partners in the Kuney Family Partnership for Federal income tax purposes.

REBUTTAL OF GOVERNMENT'S ARGUMENT

Rebuttal to Point I

The Government seeks to sustain its position in this case on the ground that the donors-adult Kuneys "* * * retained and exercised control over both the property purportedly transferred and the income earned therefrom, * * * " since there was no "concrete evidence that the donee-trustee acted independently of the taxpayers or that the taxpayers no longer maintained dominion and control over the property and its income."

The Government has erroneously relied on *Commissioner v. Culbertson,* 337 U.S. 733; *Commissioner v. Tower,* 327 U.S. 280, and *Lusthaus v. Commissioner,* 327 U.S. 293, in an effort to inject the theory "that where the services contributed by the donee partners are not 'vital' and 'he has not participated in management and control of the business' or contributed 'original capital' the taxpayer has a 'heavy burden' to prove the above ultimate fact."

One need only read Section 191, of the Internal Revenue Code of 1939, as added by the Revenue Act of 1951 and the committee report thereon to conclude that the Government is endeavoring to interpret the law as it existed prior to that amendment.

Since that time a person or trust is to be recognized as a partner for income tax purposes "if he owns a capital interest in a partnership in which capital is a material income producing factor" irrespective of whether or not he purchased the interest (See Sec. 704 (e) IRC, 1954). This statute, and its predecessor Section 191,

preclude the previously common determination of the Government that a partnership was invalid because the family member paid nothing for his interest in the partnership or performed vital services. Stated simply, the validity of the partnership under the statute in such cases depends upon whether or not there had been an effective gift of the partnership interest.

In *Peterson, et al. v. Gray,* 59-2 USTC ¶9692, trusts were established for taxpayers' infant daughter who was then two years of age. The trustee, the Kentucky Trust Company, was made a limited partner. The court found that the compensation paid to taxpayer was reasonable for the periods involved. The net profits of the partnership were divided among the capital interests in proportion to their capital investments. The District Court rendered its decision in favor of taxpayer concluding:

> "In view of the wording and history of the 1951 amendments, the court concludes that a family partnership must now be recognized for income tax purposes where the transfer of ownership to the family members was, as here, real and bona fide and not a mere pretense or sham."

In *Stanback, et al. v. Commissioner,* CA 4, 271 F. 2d 514, the taxpayers, two brothers, had a proprietary medicine business which they conducted as partners. In 1937 and 1938 each transferred an undivided 6% interest in the partnership to each of three trusts he had created for the benefit of his wife and minor children. A valid limited partnership was at that time created. Each partner's participation in income was proportionate to his capital interest, nothing

being allocated to the general partners for their personal services. After reviewing the *Culbertson* decision, the court concluded: "Whether one may be said to be technically a partner, if he is the real owner of an undivided interest in a business, earnings properly attributable to that interest should be taxed to him. If he be the true owner of the interest, it matters not that the interest was given to him, as the Tax Court recognized in this case."

In discussing the 1951 amendments, the court stated: "It was not a codification of the Culbertson rule, as generally applied in the lower courts, for that rule was concerned with the recognition of partnership agreements, not with the taxation of investment income to the owner of the investment."

In discussing the requirement of contributions of original capital or of vital services the court stated:

> "The business purpose requirement was satisfied, according to the new view, if a donee of an undivided interest in an existing partnership was the real owner of the interest, though the transaction was not intended to benefit the business of the partnership. Trustees as partners were to be recognized, and the case of a limited partner was not to be prejudiced because the general partners exercised the complete control contemplated by applicable state statutes."

In reviewing the Tax Court, the court stated:

> "Capital interests in a partnership are not inalienable. They may be transferred by a parent to a child. The difficulty which family partnerships have encountered in obtaining tax recognition

> arose out of their employment to transfer earnings from the personal services of active partners to their inactive dependents. The approach of *Mim.* 6767 provides a basis, subject to proper control through the exercise of the Commissioner's power to reallocate income, of recognition of the transferee as the owner of income produced by his capital while withholding recognition of him as the owner of income properly attributable to the personal services of others. Thus the taxation of the owner of a capital interest in a partnership is harmonized with that of an owner of a capital interest in a corporation, while the evil inherent in a ready acceptance of the partners' allocation of income is avoided."

The amendment by the Revenue Act of 1951 and its carryover to the 1954 Code as Section 704(e) therefore permits the creation of a family partnership by gift where capital is a material income producing factor, but requires that the partnership income be allocated in accordance with capital ownership and services performed. Since in this case, services were compensated and income thereafter divided in accordance with the law; the true owner of the interest in the Kuney family partnership is being taxed as contemplated under the law.

Rebuttal to Point II

The Government has attempted to attack the bona fides of the gifts by taxpayers on the ground that the only testimony introduced was that of the adult Kuneys which is purportedly self serving and therefore need not be believed. The statements of the taxpayer-trustees that they were fully aware of their responsi-

bilities as trustees and their conduct in administration of the trusts is certainly the best evidence of the bona fides of the gifts.

In addition the Government argues that in order to make a bona fide gift in trust a grantor *must* appoint a third party trustee who *must* be entirely independent of grantor and who *must* approach the administration of the trust income and property on an entirely third party basis, such as a banking institution. This theory is so contrary to well established trust law that further rebuttal argument is unnecessary.

The Government seeks to create the impression that the interests of the trusts in the Kuney Family Partnership were not fully disclosed to creditors and supports its position by asserting "Each of the statements omitted any reference at all to the trusts when describing the various partners (Exs. 30, 31, 32, GB Appendix B, *infra.*)." It seems incredible that the Government would seek to persuade this court of a fact which is plainly inaccurate. Not only does one of the printed pages of Ex. 30 (GB77) show "Max J. Kuney & Trust" and "Max Kuney, Jr. and Trust" but also page 15 of each exhibit shows the same and page 14 of each exhibit shows "Distribution of Net Income — Max J. Kuney and Minor Child" and "Max Kuney, Jr. and Minor Children" and Partner's Source of Profit and Net Worth After Withdrawals—"Max J. Kuney & Child" and Max Kuney, Jr. & Children." These financial statements also state that "any agency named herein is hereby authorized to supply any party to whom this statement is submitted with any informa-

tion necessary to verify it." This clearly shows that all interested parties could certainly ascertain the existence of the trusts. Furthermore, it should be noted that the only financial obligation, other than current accounts payable, was periodic loans from the Seattle-First National Bank only and at all times there were sufficient current assets to meet the current accounts payable. The lack of testimony by disinterested witnesses, such as other creditors as referred to by the Government, is the natural result of this situation where in fact no other creditors existed.

Rebuttal to Point III

The gifts of the partnership interests by the adult Kuneys made no change in the management or control of the partnership. However, the Government has failed to distinguish between the "management" of the business affairs of the Kuney Family Partnership by the "managing partners," the adult Kuneys, and the "ownership" of a part of the partnership capital by the trusts as administered by the adult Kuneys. Clearly, the trustee partners have the same rights of investment, withdrawal and reinvestment of capital owned by them in the Kuney Family Partnership as do the adult partners in the Kuney Family Partnership.

It has never been questioned that the adult Kuneys could withdraw their own capital from the Kuney Family Partnership, invest it elsewhere, or spend it for personal desires. The same rights existed as trust partners except that as a fiduciary none of the income or corpus of the trust could be expended for other than the purposes plainly outlined in the trust instruments.

At any time a trust partner desired to invest the trust property other than in the Kuney Family Partnership no obstacles existed. There were sufficient funds available at any time to permit this and neither a "heated discussion" nor any discussion between the managing partners would be required to accomplish this. There was never any reason to question the advisability of investing in the Kuney Family Partnership since this had, since its inception, been the practice of the trustees and had proven to be more profitable than any other investments available to the trustees.

This shows that the trustees had the same rights and duties as a third party trustee would have had with respect to the trust property and illustrates that the management and control of the business was affected in the same way by the appointment of the adult Kuneys as trustees as it would have been affected if a third party trustee had been appointed in their stead.

Rebuttal to Point IV

The exhibit as corrected and explained below in necessary particulars, shows that taxpayers neither retained or exercised control over the income earned by or distributed to the trusts.

The record shows that a blackboard exhibit was prepared by the Government the first day of the trial, and erased. A second blackboard exhibit was prepared in the court room by taxpayers' lawyer, Mr. Toole, and his accountant, Mr. Bowen, during the morning of the second day of the trial, while Mr. Toole's assistant, Mr. Harmon, was conducting the examination of witnesses Mr. Henry and Mr. Coon. As prepared, this exhibit appeared thus (R213):

FIXED ASSETS			SURPLUS CAPITAL		
ROFIT %	TRUSTS	PROFIT %	ADULTS	CHILDREN	TOTA
56%	250,000	44%	740,000	30,000	$1,325
0	000	0	(400,000)	000	(400
56%	250,000	44%	340,000	30,000	925

Max J. Kuney Company Corporation was completely ormed June 1, 1953, and not January 1, 1955. From lay 11, 1953 to June 1, 1953 it was in the process of ormation. On May 11, 1953 Max J. Kuney Company artnership had agreed to transfer all its assets except xed assets, to Max J. Kuney Company Corporation, n exchange for its capital stock. On May 31, 1953 a tock certificate showing 400,000 dollar shares of cororation stock was prepared showing Max J. Kuney ompany General Partnership, the owner. All legal ormalities had been completely and precisely observed nd the corporation was ready to be born (Exhibits 3a, 3b, 3c, Q4). On June 1, 1953 Max J. Kuney Comany Corporation was born. Its assets included all the ssets except fixed assets and all the liabilities of the redecessor partnership. Its assets equalled its liabiies and its liabilities included the capital of Max J. uney SR. and Max J. Kuney JR., and also loans payble to minor children John R. Kuney, Max J. Kuney II, and Caroline I. Kuney.

On January 1, 1954 the total assets of the Kuney amily Partnership included all the fixed assets (ma-

chinery, equipment, land, and buildings) owned by that partnership on May 31, 1953, plus purchases, less sales to December 31, 1953. Such fixed assets were the total assets of the Kuney Family Partnership and they amounted to $504,033.72. The capital of the adult Kuneys, their trusts and their minor children was as follows:: :

EDULE B. SUMMARY OF PARTNERS' CAPITAL ACCOUNTS AND INCOME DISTRIBUTION (PER CENT)
JANUARY 1, 1954 AND JANUARY 1, 1955

EY PARTNERSHIP CAPITAL NT . PARTNER	JANUARY 1, 1954 AMOUNT	JANUARY 1, 1954 PER CENT	JANUARY 1, 1955 AMOUNT	JANUARY 1, 1955 PER CENT	JANUARY 1, 1955 AMOUNT	JANUARY 1, 1955 PER CENT
1 Max J. Kuney, Sr.	138,782.60	27.26	149,975.68	26.74		
2 Max J. Kuney, Jr.	138,782.60	27.82	149,975.69	26.74	299,951.37	53.48
3 Trust: John R. Kuney	115,786.00	22.74	133,958.46	23.90		
4 Trust: Max J. Kuney III	55,341.26	11.09	63,431.01	11.31		
5 Trust: Caroline I. Kuney	55,341.26	11.09	63,431.01	11.31	260,820.48	46.52
AL KUNEY PARTNERSHIP CAPITAL	504,033.72		560,771.85		560,771.85	
estment in Max J. Kuney pany Corporation by J. Kuney, Sr. and Max J. ey, Jr.						
orporate Capital Stock	400,000.00		400,000.00		400,000.00	
orporate Capital Surplus	290,199.86		334,059.64		334,059.64	
ns to Max J. Kuney Company poration by John R. Kuney, J. Kuney, III and oline I. Kuney	28,922.56		30,380.44		30,380.44	
erred Credits			180.00		180.00	
ALS REPORTED ON INCOME TAX URNS:						
or Year 1953, Exhibit 12	1,223,156.14					
or Year 1955, Exhibit 38A-1			1,325,391.93		1,325,391.93	

Based on these indisputable facts it is obvious that Court's Exhibit 2 must have been incorrect. A few of the major errors are: (1) The title "Investments in Business 1-1-55" indicates one business. (2) The date "1-1-55" should be 6-1-53, the date Max J. Kuney Company Corporation was born. (3) The Kuney children have never had any investment in "Surplus Capital," but had loans to Max J. Kuney Company Corporation. (4) The exhibit should have shown Kuney Partnership capital plus Kuney corporation capital Total $1,295,-000, instead of "Fixed Assets" plus "Surplus Capital" "Total $1,325,000." (5) "Corporate Stock Withdrawal" was nothing instead of $400,000. Court's Exhibit 2 correctly titled appears below:

COURTS EXHIBIT 2 CORRECTLY TITLED	KUNEY PARTNERSHIP				KUNEY CORPORATION		
	CAPITAL ADULTS		CAPITAL TRUSTS		CAPITAL ADULTS	CAPITAL CHILDREN	TOTAL
	AMOUNT	%	AMOUNT	%			
INVESTMENT IN BUSINESS 1-1-55	305,000	56%	250,000	44%			$555,0
INVESTMENT IN BUSINESS 1-1-55 CAPITAL STOCK					400,000		
CAPITAL SURPLUS					340,000		$740,0
LOANS TO KUNEY CORPORATION BY CHILDREN JOHN, MAX J. III AND CAROLINE I. KUNEY						30,000	30,0
CORPORATE STOCK WITHDRAWAL	000	0	000	0	000	0	
INVESTMENT AFTER STOCK WITHDRAWAL	305,000	56%	250,000	44%	740,000	30,000	1,325,0

Since Mr. Toole's questions and Mr. Bowen's answers were based on an incorrect exhibit, Mr. Bowen's testimony was incorrect. Naturally the trial judge became confused and rendered an erroneous decision.

In all cases here, partnership rental income depends on the business need of the corporation for partnership assets. No change in partnership income could be accomplished by the taxpayers unless unneeded assets were bought or needed assets were sold. To do this would be "foolhardy" (R284), and the record shows that this was never done.

Rebuttal to Point V

Taxpayers' control over the assets essential to the partnership business was absolute. The statement, "Partnership assets were even pledged as security on loans to the corporation in which the trusts had no interest whatever." (GB40), is incorrect. See Point 8, CORRECTION OF GOVERNMENT STATEMENT OF FACT, *supra.*

Rebuttal to Point VI

"The Kuney Family Partnership was formed by the two adult Kuneys to reduce their Income Taxes while living and to save inheritance taxes at their death." (Ex. G). As pointed out in TB5A " * * * where there is a real transfer of ownership, a gift of a family partnership interest is to be respected for tax purposes without regard to the motives which actuated the transfer, * * * ".

Rebuttal to Point VII

Incidents of ownership to the complete extent that would necessarily exist in a grantor-trustee partnership do not invalidate a family partnership trust for Federal Income Tax purposes under existing law. However, in the instant case taxpayers did not retain the substantial incidents of ownership, dominion and control to the extent that could be permissible under the law. The real control of the partnership remained with the adult Kuneys and the control of the trust property was granted to the trustees, all in accordance with the trust instruments.

Rebuttal to Point VIII

Section 677 (b) of the Internal Revenue Code of 1954, clearly spells out the circumstances under which income from a trust would be taxable to the grantor, namely that amount which is actually applied to support or maintain a beneficiary who the grantor is legally obligated to support or maintain. In the instant case there has been no application of any income which could make either grantor taxable under this Section.

CONCLUSION

For the reasons given above, the decision of the District Court is incorrect and should be reversed.

Respectfully submitted,

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